California INTERNATIONAL LAW Section Newsletter

State Bar of California

# A Letter from the Vice Chair
## September 2002

**David L. Teichmann**
**Vice Chair, Executive Committee**

Greetings from the Executive Committee of the International Law Section! Our Chair, John McNeece, is on sabbatical at the moment, but he asked me to briefly share a few important notes with you as we exit the summer and prepare to embrace autumn.

This past year has been one of deep reflection for most of us as we have witnessed both the promise and the shortcomings of international legal principles, institutions and theories. As the anniversary of September 11th nears, it is clear that international law continues to play a key role in ordering affairs among nation states and increasingly is being used to judge the actions of individual actors on the world stage. In the year ahead, our section has both a responsibility and an opportunity to keep our members informed about these developments and to increase public awareness of the role played by international law.

The lifeblood of our section are the programs that our members organize each year. A variety of programs are being offered in the months ahead, many of which were discussed in the May 2002 Newsletter. By way of reminder, please calendar what promises to be an exceptional conference at Hastings Law School in San Francisco on September 14th entitled "U.S. Courts as Arbiters of Global Human Rights." Russell Kerr of our Executive Committee has lined up a superb group of practitioners, many of whom have been in the press recently due to the notoriety of their human rights cases. For more information, please see www.calbar.org/ils.

Additionally, our section has 10 panels planned for you at the State Bar Annual Meeting in Monterey from October 11th - 13th. Details about the panel times, topics and locations can be found at the State Bar's website at www.calbar.ca.gov. We hope to see many of you in Monterey and invite you to approach the Executive Committee members and other speakers if you have ideas for future programs or would like to take a more active role in the section. Our activities ultimately reflect the participation of volunteers like you, so please be encouraged to contribute your ideas and time.

On November 5th, our members in the Los Angeles and Orange County area will have the chance to attend a one-day program on international commercial law entitled "Reducing Payment Risk in International Transaction: How to Make Sure Your Client (and You) Get Paid." The speakers will focus on pragmatic and practical tips that will surely be useful in today's increasingly challenging international business climate.

Next January 17th - 19th the ILS will be sponsoring a number of programs at the Winter Section Education Institute set for the Claremont Resort and Spa in Berkeley. Please see the next newsletter for program details, but mark your calendars in the meantime. Also, if you wish to present a program at the Winter SEI or wish to organize a future ILS event, you should contact our incoming Vice Chair for Programs, Lisa Mammel, at mammella@cooley.com.

We look forward to welcoming you to our programs and events during the year ahead and hope that many of you will take the initiative to become more active members in the section. This is a defining

# Letter from the Vice Chair

***(continued)***

moment for our nation and for the global order. Let's all do our best to make a positive contribution, individually as well as through institutions such as the ILS and other international organizations to which we may belong.

On behalf of the entire Executive Committee, thank you for your interest and support.

Kind regards,
David L. Teichmann

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# GLOBALIZATION:
## U.S. COMPANIES AT A TAX DISADVANTAGE


By: Stephen A. Malley J.D.
Research Assistant, Tamar Malley Hill (UCLA School of Law)
Law Offices of Stephen A. Malley
12424 Wilshire Boulevard, Ste 1200
Los Angeles, California 90025
(310) 820-7772
(310) 820-8870 (fax)
Email: *samalley@earthlink.net*


### *I. INTRODUCTION*

US business must be internationally competitive to take advantage of global markets. The significance of globalization is illustrated by the reports that almost 80% of world purchasing power, and of world income, is derived from sources outside the United States, and that sales of S&P 500 Companies grew 10% annually, compared to domestic growth of 3%, from 1986 to 1997.

The United States tax system burdens US companies with significant disadvantages and may be the primary reason that only eight of the world's twenty largest corporations are headquartered in the US, down from eighteen in 1960.

As examples of tax disadvantages to US companies, consider the following:

(1) The combined US and state corporate tax rates are substantially higher than the corporate rates imposed by most other industrial countries. EU countries average a corporate tax rate of 31.8%, and OECD countries average 30.5%, as against 35% in the US. The OECD (Organization for Economic Development and Cooperation) has thirty permanent Member Countries, and includes all the major economies.

(2) The US imposes a double tax burden on corporate dividends, taxing both corporate profits and then dividends. The US, Netherlands, and Switzerland are the only OECD countries which do not allow a total or partial tax credit on corporate dividends. This tax burden has far reaching effects, and it discourages investment and may well contribute to Wall Street's short-term view of corporate performance. Sale of an entire company, for example, will result in the lower capital gain tax rate to selling shareholders, and the emphasis on short-term profits to enhance the sale price has often proven to be counterproductive.

(3) While income tax treaties normally allow a tax credit for taxes paid to a foreign country, there are significant restrictions on the use of such credits. US companies are subject to the Alternative Minimum Tax on Foreign Tax Credits, and foreign tax credits are limited to 90% of alternative tax liability. Unused tax credits can be "carried back" for only two years, and "carried forward" for only five years.

(4) US companies are generally required to take the profits of foreign subsidiaries into current tax computations. At least half of OECD countries, however, do not tax a parent company on the active income from a foreign sub-

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countries tax corporations on a "territorial basis", and profits from active overseas subsidiaries are generally exempt.

## II. SUBPART F RULES

US companies are subject to the arcane tax rules, known as "Subpart F", which are designed to prevent US companies from deferring tax on profits earned by overseas subsidiaries. The Subpart F rules are essentially formulated to prevent the use of low tax jurisdictions as a conduit for services or manufacturing. There are compelling reasons for US companies to establish overseas subsidiaries. Objectives might include obtaining lower labor, shipping, and materials costs; participation in the benefits of the EU; protecting the parent company's assets from overseas liabilities; and customers' requirement of a "local" company.

Congress has periodically examined the Subpart F rules and the most recent and comprehensive effort to enhance the competitiveness of US business is embodied in H.R. 5095, the "American Competitiveness and Corporate Accountability Act of 2002. This proposed legislation would repeal the Subpart F Anti-Deferral Foreign Base Company Sales and Services Rules. Other proposed legislation includes the "International Tax Simplification and Fairness for American Competitiveness Act of 2002", introduced March 21, 2002, which would raise the Subpart F de minimis threshold to $5,000,000, repeal the Foreign Investment Company and Foreign Personal Holding Company rules, extend the Foreign Tax Credit Carryover to ten years, and repeal the Alternative Minimum Tax on Foreign Tax Credits. Passage of these Bills is uncertain as of this writing.

## III. CORPORATE MIGRATION TO TAX HAVENS

US tax rules have been the motivating force to corporate "migration", or "inversion" to low tax jurisdictions. A US corporation may reincorporate, or merge with its foreign subsidiary, to become, e.g. a Bermuda corporation, and thereby avoid corporate level tax on profits earned outside the US, i. e. not from US source business activities. Ingersoll-Rand, Tyco, Cooper Industries, and Stanley Works are just a few of the larger US companies to migrate overseas to Bermuda, and it is unknown how many privately held businesses have done the same. These companies often have no real operations in the low tax jurisdiction of incorporation, but instead may have only a mail drop or a "representative office" with no employees.

This migration of prominent and public US companies has also attracted the attention of Congress. A number of House and Senate Bills purporting to prevent corporate inversion have been introduced. H.R. 5095 seems, again, the most comprehensive. Unfortunately, H.R. 5095, entitled "American Competitive And Corporate Accountability Act, is a heavy-handed approach, that does not address tax inequities. First, the Bill imposes a 3-year moratorium on inversions. In addition, it penalizes inversions by imposing a tax on assets transferred offshore, and by denying the use of foreign tax credits, net operating losses, or "other tax attributes" ordinarily used to shelter such transfers. The Bill also imposes a 20% tax on executive and "insider" stock options at the time of the "inversion".

H.R. 5095 regrettably also contains provisions, which seem anti-competitive and harmful to US subsidiaries of foreign corporations. For example, the Bill would substantially limit the deductibility of interest paid to a foreign parent, by modifying IRC 163(j) to tighten the rules defining "disqualified interest" and by denying any carry-forward of "disqualified interest".

It should be noted that current law already discriminates against US subsidiaries of foreign corporations by imposing arbitrary limitations on deductibility of interest paid to the parent, (interest deductibility is denied unless the US subsidiary maintains a 1.5 debt-to-equity ratio and interest is less than 50% of adjusted taxable income). US companies, on the other hand, generally are subject only to a "facts and circumstances" test. (IRC Sec.385). H.R. 5095 would substitute more burdensome tests which could cause foreign companies to avoid the use of US subsidiaries, because interest payments to a "related party" would be denied if the US debt-to-asset ration exceeds that of the world-wide affiliated group, or if interest exceeds 35% of adjustable taxable income.

Passage of these Bills or any of them is uncertain as of this writing.

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## IV. THE WTO AGAIN RULES AGAINST US TAX CREDITS FOR EXPORTING

The US enacted legislation entitled The Extraterritorial Income Exclusion ("ETI"), in November 2000 to allow a limited tax exemption on income earned by US companies from exports. Its purpose is to enhance the competitive position of US companies. The ETI replaced the Foreign Sales Corporation regime ("FSC") enacted in 1984, and which the World Trade Organization ("WTO") found to be an illegal subsidy. (The ETI actually allows more tax benefits than did the FSC.) Unfortunately, the WTO recently held that the ETI is also an illegal subsidy, and now that the ruling has been upheld by the WTO Dispute Settlement Body, the WTO is threatening to levy substantial sanctions against the US. Representative Amo Houghton, Congressman from New York, has introduced legislation to repeal the ETI, and reportedly replace it with other tax benefits. Large exporters, like Boeing and Motorola, report that ETI tax savings represented more than 10% of their total net income from 1996 to 2000.

In any case, the ETI will likely disappear, as the US is not likely to allow the WTO to impose sanctions. While the WTO is often criticized for, among other things, attempting to alter national tax structures, commentators agree that the ETI is doomed.

Congress may find it difficult to replace the ETI with a tax benefit acceptable to the WTO, because the US derives its tax revenue largely from income taxes, while most EU and OECD countries depend on " consumption taxes", commonly known as VAT. Of the 30 OECD Members, the US alone does not have a VAT. The VAT system provides a subsidy to exports simply because exported products are not subject to the VAT in the country in which goods are manufactured.

## V. SUMMATION

The US tax system clearly puts US companies with global activities at a competitive disadvantage. It also unfairly burdens US subsidiaries of foreign companies Congress is recognizing the problem, but pending Bills would seem to be framed for the primary purpose of preventing or penalizing corporate migrations or "inversions", rather than implementing tax simplification to enhance competitiveness. Furthermore, US membership in the WTO may make it difficult to enact export tax incentives for US companies. The US depends on income tax, and EU and OECD countries generally depend on the VAT system, which provides an advantage to exporters. The WTO focuses on income tax disparities, and not on the VAT system.

We can expect that Congress will pass some form of the pending bills. In the meantime, US companies should take advantage of current law and treaties to maximize their competitive position through careful and informed tax planning.



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*i. US Tax Policy and International Competitiveness, Peter R. Merrill, Practical UD/Int'l Tax Strategies, 3/15/02*
*ii. Ibid*
*iii. Council for Capital formation, 11/28/01;Jeffery Owens, Tax Notes International*
*iv. IRC 954 et seq*
*v. H.R. 5095, Rep Bill Thomas (R-Ca), June 21,2002*
*vi. H.R. 4047, Representative Amo Houghton, R-NY, 3/21/02*
*vii. Wall Street Journal 5/1/02*

*Statistical information from sources including "US Tax Policy and International Competitiveness", Peter R. Merrill, Price Waterhouse Coopers LLP, World Trade Executive, Inc., March 15, 2002.*

### *EMAIL DISTRIBUTION*

If you have not send in your email address to the Membership Dept. to receive this newsletter electronically, please do so today as this will save our Section postage and printing costs. Send your email address in writing to: The Membership Dept., State Bar of California, 180 Howard Street, San Francisco, CA 94105. Include your bar number and don't forget to sign the letter.

# IMMIGRATION LAW UPDATE

By: David Hirson, Esq. &
Catherine Mayou, Esq.
HIRSONWEXLERPERL
4685 MacArthur Court, Suite 400
Newport Beach, California 92660
Telephone: (949) 251-8844
FAX: (949) 251-1545
Email: dhirson@hirson.com
Email: cmayou@hirson.com
www.hirson.com

United States immigration laws, regulations, and policies are in a constant state of flux. While it is critical to have a legal system that has the flexibility to deal effectively with changed circumstances or emergent situations, the flip side is that confusion and panic is prone to spread like wildfire amongst those who are impacted by these changes, and keeping abreast of new laws to ensure compliance can be an enormous challenge in itself. The following is a brief discussion of some recent changes in immigration laws, regulations, and policies and the impact that these changes have on the lives of foreign nationals living in the United States.

**All Foreign National Must Notify the Immigration and Naturalization Service ("INS") of an Address Change within 10 Days.**

All foreign nationals in the United States whether temporary workers, students **or permanent residents** must notify the INS in writing of their change of address **within 10 days**.

This requirement is found under Section 265 of the Immigration and Nationality Act, as amended and although this provision of the law has been in existence for decades, historically, it has received little attention by the INS. However, in the wake of September 11th, and for reasons that have become painfully and embarrassingly clear to the INS over the past year, the INS has begun to enforce this provision. A foreign national's willful failure to comply may result in arrest, removal (formerly "deportation"), and even criminal charges. There are isolated reports of incidents where the INS has detained individuals and instituted removal proceedings on the basis of the foreign national's willful failure to notify the INS of an address change.

This provision applies to all foreign nationals, not only to those who currently have applications pending at the INS.

**Child Status Protection Act**

On August 6, 2002, the President signed the "Child Status Protection Act" into law. This law protects foreign national children from "aging-out" or losing their eligibility for certain immigration benefits upon reaching the age of 21. Formerly, foreign national and unmarried children who accompanied their parents to the United States could qualify and apply for immigration benefits only until their 21st birthday. Often, the INS' enormous backlogs and processing delays caused many of these children to "age-out" and lose the opportunity to immigrate to the United States with their families.

If a child has "aged-out", the parents may still file a separate petition on the child's behalf. However, this process currently has over an 8-year backlog. During this time, the child must wait for permanent residence in the home country – resulting in the separation of families - unless the child is eligible for a non-immigrant visa to remain in the United States.

The new "Child Status Protection Act" makes provision for certain foreign national children of U.S. citizens, permanent residents, and asylees who will continue to qualify for immigration benefits based upon a parent's application **even if they turn 21 or age-out while their applications are pending.**

Concurrent Filing of Employment-Based Immigrant Petitions and Applications for Permanent Residence

On July 31, 2002, the INS passed an interim rule allowing two parts of the employment-based permanent residence "green card" process to be filed concurrently. Employment-based permanent residence is a lengthy process, which takes several years to complete. Often it begins with the employer filing an application with the U.S. Department of Labor to certify that there are no qualified, willing or able U.S. workers to fill the position offered to the foreign national worker. After this certification is received, the employer must file an immigrant petition with the INS. After the immigrant petition is approved and an immigrant visa number is available, the foreign national may file an application for permanent residence.

With concurrent filling, the immigrant petition and the permanent residence application may be filed together as long as there is an immigrant visa available. The INS has stated that concurrent filing will result in **faster, consolidated proc-**

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grant petition and the permanent residence application may be filed together as long as there is an immigrant visa available. The INS has stated that concurrent filing will result in **faster, consolidated processing**. Whether the INS can deliver upon this pitch, remains to be seen. Other benefits from the concurrent filings include the following: 1) A foreign national who is running out of time in nonimmigrant status may be able to maintain lawful status in the U.S.; 2) Dependents of the foreign national may also file their applications for permanent residence as well as work permits and travel documents at a much sooner date; 3) Applicants will be protected in the event that immigrant visas become unavailable (in other words, if priority dates retrogress) because they will still have an employment authorization document ("EAD") allowing employment to continue past the expiration of their nonimmigrant employment authorization.

On the other hand, concurrent filing has potential problems and pitfalls. One such pitfall results when the underlying immigrant petition is denied. The result is that the application for permanent residence will also be denied. The applicant and dependent family members will lose their EADs and potentially not be able to revert to valid nonimmigrant status.

**Conclusion**

The above recent changes in U.S. immigration laws reflect changes in the attitudes and politics of the United States. They reflect a desire to control immigration and to keep families together, two extremely important and often conflicting considerations that make this area of law so unpredictable and fraught with challenges.

*For more information about the topic of this update or for immigration law matters in general, please contact David Hirson and/or Catherine Mayou, co-editors of this newsletter and partners of the law firm of HirsonWexlerPerl, a firm that specializes in Immigration and Naturalization Law.*

***OTHER ACTIVITIES OF INTEREST . . .***

U.S. Courts as Arbiters of Global Human Rights program presented at Hastings College Law on 14 September 2002. Information about the program, speakers and registration material is available online at www.calbar.org/ils/2002-09-14_global-human-rights.pdf

High Technology and the Emerging Digital Economy: Legal Challenges in the U.S. and EU, 7-8 October 2002 in Los Angeles at the Beverly Hills Hotel. For information and registration at www.ibanet.org/general/ConferenceOverview.asp?ID=621&Section&Committee=

International Bar Association biennial conference in Durban, South Africa, 20-25 October 2002. For information and registration at www.ibanet.org/durban/index.asp

International Law Section of the State Bar program on Reducing Payment Risk in International Transactions: How to Make Sure Your Client (and You) Get Paid, 5 November 2002 in Los Angeles, Olympic Collection Conference Center. For information and registration at www.calbar.org/ils/2002-risk.htm

## The U.S. COURTS AS ARBITERS OF GLOBAL HUMAN RIGHTS

program is being presented at Hastings College of Law on September 14, 2002 by the State Bar of California International Law Section in association with the ABA Section of International Law & Practice Human Rights Committee. The program will address recent developments in human rights litigation under the Alien Tort Claim Act, the Torture Victim Protection Act and the terrorist exception to the Foreign Sovereign Immunities Act and offers 8 hours MCLE credit plus a one-hour Ethics Tape (Self Study).

Our prominent guest speakers include attorneys from the Center for Constitutional Rights, Center for Justice and Accountability, International Labor Rights and Earth Rights International as well from several prestigious law firms defending these claims. Each of our guest speakers is actively litigating one or more of these closely watched human right cases against multinational corporations.

Information about the program, speakers and registration material is available online at http://www.calbar.org/ils/2002-09-14_global-human-rights.pdf or email Russell Kerr at russell@kerrlawfirm.com

Russell Kerr, Esq.
*Kerr & Associates*
*16480 Harbor Boulevard #100*
*Fountain Valley California 92708*
*Telephone: (714) 531-5900*
*FAX: (714) 839-2635*
*Email: russell@kerrlawfirm.com*

# REDUCING PAYMENT RISK IN INTERNATIONAL TRANSACTIONS: How to Make Sure Your Client (and You) Get Paid

***International Law Section***
***State Bar of California***
**November 5, 2002**
**Los Angeles, CA**

When a buyer is located in an emerging market, the financing challenges and risk factors of a transaction multiply. This program of leading authorities and experienced practitioners will provide invaluable advice on how to reduce the credit risks of sales to such buyers while creating financing terms that encourage sales.

***8:30-9:30 International Credit Risk Assessment***
An overview of political and commercial risks in international transactions and the various tools and sources of information available to determine the creditworthiness of a foreign party and the creditworthiness of the foreign party's home country.

Panelists: Steven DeLateur, Law Offices of Steven DeLateur and former Loan Officer EXIM Bank; Donal Hanley, Director Legal, Tombo Aviation; Gary Mendell, President, Meridian Finance.

***9:30-10:30 Government and Private Risk Reduction Programs***
Credit insurance and bank guarantees through the Export-Import Bank and private entities.

Panelists: Steven DeLateur, Law Offices of Steven DeLateur; Gary Mendell (Meridian Finance).

***10:30-11:30 Using Letters of Credit to Reduce Payment Risk***
A primer on use of letters of credit and stand-by letters of credit in international transactions.

Panelists: Paul Turner, Retired Assistant General Counsel Occidental Petroleum, Gerald McLaughlin, Professor and former Dean, Loyola Law School.

11:30-12:00 The Foreign Corrupt Practices Act: Using and Paying Foreign Sales Agents and Making Sure Your Client Doesn't Go to Jail

*Speaker: John Liebman, McKenna Long & Aldridge LLP.*

12:00-12:30 International Insolvency Issues: What to Do When the Foreign Party Becomes Insolvent.

*Speaker: Arnold Quittner, Pachulski, Stang, Ziehl & Young*

**Date and Location:** November 5, 2002 in West Los Angeles at the Olympic Collection conference center at the intersection of the Santa Monica and San Diego Freeways**.** 11301 Olympic Blvd., Los Angeles, CA 90064**.** Registration begins at 8:00 a.m.

**Cost, MCLE and Registration:** $90 for International Law Section members ($95 for non members). Up to 5 hours of MCLE credit, including an optional one-hour MCLE self-study tape on elimination of bias. For registration information, click http://www.calbar.org/ils/2002-risk.htm or call (415) 538-2380

*The State Bar and the International Law Section are State Bar of California MCLE providers.*

# CALL FOR ARTICLES

The Editors of this newsletter are inviting members of the Section and others to submit articles relating to international issues.

## Editors:

Catherine I. Mayou, Esq.
Co-Editor
HirsonWexlerPerl
4685 MacArthur Court
Newport Beach, CA 92660
cmayou@hirson.com
Phone: (949) 251-8844
FAX: (949) 251-1545

David Hirson, Esq.
Co-Editor
HirsonWexlerPerl
4685 MacArthur Court
Newport Beach, CA 92660
dhirson@hirson.com
Phone: (949) 251-8844
FAX: (949) 251-1545

The Editors reserve the right to edit articles for reasons of space or for other reasons to decline to print articles that are submitted. We will consult with authors before any editing.